

numac energy
growing according to plan



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In 1996, we implemented a plan to bring Numac to a position of profitability and growth. Over the past two years, we have made significant progress in building our reserves, production and undeveloped land base. Going forward, we plan to capitalize on those achievements.

profile Based in Calgary, Alberta, Numac Energy Inc. is engaged in the exploration for and development, production and marketing of crude oil, natural gas and natural gas liquids in western Canada. Numac Energy ranks among the top 25 crude oil and natural gas exploration and production companies in Canada.

Numac's common shares are listed for trading on the Toronto, Montreal and American stock exchanges under the symbol NMC.

vision Establish Numac as the company of choice for investors, partners and employees by generating superior returns through successful exploration, production and marketing of hydrocarbon resources.

objective Establish Numac as a "top 15" Canadian oil and gas exploration and production company by the year 2000 by achieving production volumes in excess of 60,000 barrels of oil equivalent per day.

The Annual Meeting of the Shareholders of Numac Energy Inc. will be held at 9:00 a.m. (Calgary time) on Wednesday, May 13, 1998 in the Metro Ballroom at the Metropolitan Centre in Calgary, Alberta. Shareholders are encouraged to attend. Those unable to do so are asked to sign and return the Form of Proxy mailed with this report.

Highlights

Years ended December 31

1997

1996

FINANCIAL

(\$ thousands, except per share amounts)

Revenue	257,137	239,997
Funds from operations	128,196	122,058
Per share	1.33	1.30
Net income	12,602	16,933
Per share	0.13	0.18
Capital expenditures		
Exploration and production	173,371	106,327
Acquisitions	141,071	86,388
Proceeds on sale of property	60,099	24,373
Total assets	806,975	689,596
Long-term debt	267,484	191,739
Shareholders' equity	394,020	388,358

OPERATIONS

Production

Crude oil and natural gas liquids (Bbls/day)	20,537	18,860
Natural gas (Mmcft/day)	141	129

Expenses per BOE of production

Operating expense	4.98	3.92
General and administrative expense	0.56	0.81

Established reserves⁽¹⁾

Crude oil and natural gas liquids (Mbbbls)	69,000	60,946
Natural gas (Bcf)	554	475

Reserve life index⁽²⁾ (years)

Crude oil and natural gas liquids	9	9
Natural gas	11	10

Undeveloped land holdings (thousands of net acres)

Canada	2,228	2,248
International	295	295

Wells drilled

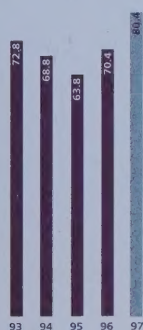
Gross	271	283
Net	173	118
Success rate	94%	93%

⁽¹⁾ Proved plus 50% of probable reserves.

⁽²⁾ Based on established reserves.

proved plus probable reserves

crude oil
and gas liquids
(Mmbbls)



natural gas
(Bcf)

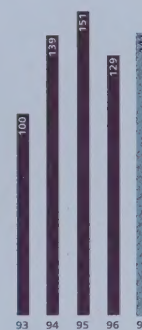


production

crude oil
and gas liquids
(Mbbbls/day)



natural gas
(Mmcft/day)



strategies

Focused capital spending, balanced for risk and reward.

achievements

Drilled 173 net wells with a 94% success rate.

Added 31.7 MMBOE of reserves, replacing 251% of reserves produced in the year.

Reduced reserve replacement costs by 18% to \$8.01 per BOE.

net wells drilled



Strengthen interests in core areas.

Acquired the Canadian oil and gas assets of Wainoco Oil Corporation, including 155 Bcf of gas equivalent reserves, 43 Mmcf/day of gas equivalent production and 121,500 net acres of undeveloped land.

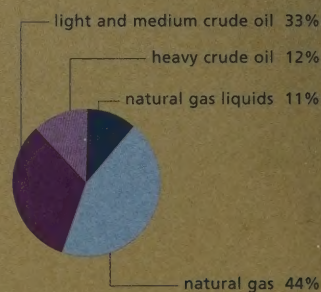
Acquired 100,000 net acres at Crown land sales and from third parties.

undeveloped land holdings in western Canada
(millions of net acres)

Improve balance between oil and gas reserves and production.

Increased natural gas component of reserves and production through Wainoco acquisition – over 80% of reserves and production acquired was natural gas.

Increased production exit rates to 21,100 Bbls/day for oil and gas liquids and 155 Mmcf/day for natural gas – improvements of 7% and 29%, respectively, from the prior year.

proved reserves
(103.1 MMBOE)

future plans

Pursue extensive multi-zone oil and gas exploration prospects in northeast British Columbia, including significant exposure to the Doig oil play.

Expand new venture exploration, with an emphasis on high impact natural gas prospects in the Walrus/Ekwan area of northern British Columbia and crude oil potential at Ante Creek in central Alberta.

De-emphasize heavy oil exploration and development.

Maintain emphasis on strengthening the asset base through selective acquisitions and the sale of non-core properties.

Maintain emphasis on natural gas, both through exploration and development, and acquisitions, to further balance production mix.

Numac's strategic plan provides a framework for sustainable and balanced growth.

Aggressively exploit core producing properties.

Increased natural gas production from the Tommy Lakes/Martin Creek corridor in northeast British Columbia by 67% to 40 Mmcf/day at year-end 1997.

Increased Numac's year-end crude oil production at Suffield in south-east Alberta by 43% to 3,000 Bbbls/day and at Elswick in southeast Saskatchewan by 18% to 1,540 Bbbls/day.

total production (MBOE/day)



Optimize exploitation opportunities, particularly in the Tommy Lakes/Martin Creek corridor in British Columbia, at Suffield, Joffre, Crystal and Ferrier in central Alberta and at Elswick in southeast Saskatchewan.

Establish heavy oil as a core resource.

Raised production at Manatokan from 233 to 1,681 Bbbls/day, in addition to increasing production at Suffield.

Initiated successful exploratory drilling program for low-cost heavy oil on extensive freehold title lands in west central Saskatchewan.

Thermal (SAGD) pilot project underway on oil sands leases at Surmont, south of Fort McMurray, in north-east Alberta, at no cost to Numac.

heavy oil production (Mbbls/day)



Methodically exploit Manatokan heavy oil property and follow-up exploration success on west central Saskatchewan freehold lands as economics permit.

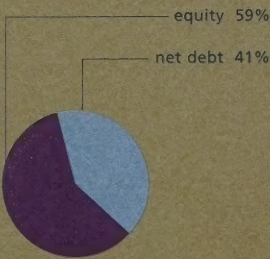
Evaluate option to convert net profits interest in Surmont project to a working interest, following completion of SAGD feasibility study.

Maintain a strong balance sheet and financial flexibility.

Reduced debt by \$85.5 million through sale of 130 non-core properties.

Exited 1997 in strong financial position with debt at approximately 2 times cash flow.

capitalization



Maintain 1998 capital program substantially within cash flow expectations.

The objective of Numac's strategic plan is to double the size of the Company by the year 2000.



Stewart D. McGregor
Chairman and Chief Executive Officer

In pursuit of our growth objective, we have adopted several strategies, including:

- the execution of a focused capital spending program in our core growth areas;
- expanding our natural gas reserve and production base in order to better balance our production mix;
- the aggressive exploitation of our core producing properties; and,
- the maintenance of a strong balance sheet.

There are two thrusts to our growth strategies:

- success with the drill bit; and,
- the acquisition of properties and production which are aligned with our strategies.

While success with the drill bit is fundamental to the sustained growth of your Company, acquisitions are also an important component of our growth strategy. The key objective of this element of our strategy is to add to and enhance our exploration and development opportunity base in those core areas targeted for growth. The timely acquisition of producing properties based on sound economic parameters also provides greater exposure to increases in commodity prices.

How have we performed in moving towards our objective during the past year? During 1997, your Company:

- undertook a record level of exploration and development spending totalling \$173.4 million, a 63 percent increase over the prior year;
- drilled 173 net wells with a success rate of 94 percent, both records for the Company;
- added 25.4 million equivalent barrels of proved reserves and 31.7 million equivalent barrels of proved and probable reserves;
- replaced 251 percent of reserves produced at a much improved replacement cost, which was 18 percent lower than the prior year;
- increased average production volumes by nine percent to 34,600 BOE/day and increased year-over-year exit volumes by 15 percent to 36,600 BOE/day;
- disposed of \$85.5 million of non-core properties, thereby giving increased focus to our asset base; and
- made a significant acquisition through the purchase of the Canadian oil and gas assets of Wainoco Oil Corporation for \$131.9 million.

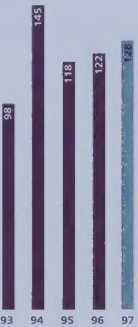
The acquisition of the Wainoco assets was an important strategic event of the past year for several reasons. First, the assets were comprised predominantly of liquids-rich natural gas reserves and production and, therefore, the acquisition was a significant step towards one of our strategic objectives – expanding our natural gas base. Second, the transaction was accretive to cash flow, was not dilutive to earnings and included tax pools well in excess of the purchase price, an unusual result of any acquisition. Third, and perhaps most importantly, the acquisition provided Numac with over 120,000 net acres of undeveloped lands, which are primarily located in northeast British Columbia, a core growth area. We are optimistic that these lands, which are prospective for both oil and gas in several horizons, will, in time, further demonstrate the strategic merits of the transaction.

While our achievements are gratifying, we recognize there is room for further improvement. Notwithstanding a significant increase in our reserve replacement ratios and a reduction in overall replacement costs, finding and development costs do not satisfy our ongoing objective. Numac's record of reserve and production growth through the drill bit has improved over the past two years, but much must yet be done to achieve our targeted finding and development cost of \$6.50 per barrel of oil equivalent. Initiatives are ongoing to further improve upon our record. These include the continued rationalization of our asset base in order to better focus our human and technical resources on core areas that can generate significant growth for the Company. Further, we continue to expand our complement of earth scientists and enhance our technical capabilities.

Financial

From a financial perspective, your Company continued to record improvement. Cash flow increased by five percent to \$128.2 million. Despite production volume gains and year-over-year improvements in natural gas selling prices, cash flow was constrained by lower crude oil prices, the commodity which comprises the majority of Numac's production base. Furthermore, heavy oil volumes comprised approximately 23 percent of total liquids production compared with approximately 11 percent in 1996. The higher component of heavy oil also had an adverse effect on operating costs. Numac's bias to crude oil production and our positive outlook for natural gas prices underscores our strategy of adding to our natural gas production.

funds from operations
(\$ millions)



Earnings of \$12.6 million were 26 percent lower than in 1996 due to increased depletion expense attributable to higher production volumes and an increase in the depletion rate by 12 percent to \$5.39 per barrel of oil equivalent. While debt levels were higher at year end as a consequence of the record level of capital spending, subsequent to the Wainoco acquisition we moved quickly to shed non-core properties in order to bring increased focus to our asset base and to reduce debt. This fourth quarter initiative was timely as prices realized exceeded even our high expectations. As a consequence, year end debt equated to just over two times 1997 cash flow.

In late 1996, Numac implemented an Issuer Bid to repurchase its common shares. Since inception of this program, which is ongoing, approximately 1.6 million shares have been purchased at an average price of \$5.51 per share. The Board of Directors was motivated to implement this program based on its view that the market price of the Company's shares have not reflected their underlying value and future potential. This view is supported, amongst others, by the Company's net asset value which is estimated to be at least \$7 per share, using a 15 percent pre-tax discount rate. This estimate is based on independent evaluations of both year end reserves and undeveloped lands, and an assessment of the value of income tax pools.

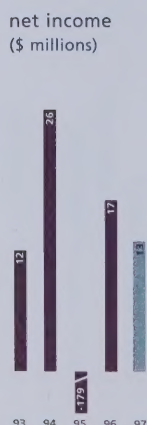
Outlook Industry Environment

Prior to addressing Numac's future plans and expectations, it is salient to discuss the competitive environment facing our industry as we enter 1998, a year which will present significantly different challenges and opportunities.

The most noteworthy change is the recent and precipitous drop in crude oil prices and, importantly for many producers, the significant widening of heavy oil price differentials. These developments were, for the most part, unforeseen.

A few short months ago, the broad consensus was a market tightly balanced between supply and demand. The economic downturn in southeast Asia, increases in OPEC production quotas and the prospect of increased production from Iraq conspired to disrupt this bright outlook. While we believe that forces will, in time, correct this price downturn, there is little evidence to suggest an early or dramatic improvement. The recent and rapid reversal of crude oil pricing does, however, underscore the unpredictable and volatile nature of this commodity. Numac's future capital spending will respond to this outlook for crude oil prices.

While the future direction of crude oil prices is not obvious, it is far less difficult to construct a bullish outlook for natural gas. We expect prices to remain firm in 1998 and strengthen thereafter. Additional transportation capacity for Alberta natural gas to mid-west and eastern U.S. markets will come on-stream in late 1998. This includes expansion of both the Northern Border and TransCanada pipeline systems which will add 1.1 billion cubic feet per day of incremental capacity. Further out, new pipeline systems are in prospect. Of particular note is the Alliance pipeline proposal which, in our view, has a strong probability of proceeding.



This proposal is of particular significance to Numac since it will provide alternative markets for British Columbia gas which constitutes approximately 46 percent of Numac's natural gas production volumes. The existence of natural gas reserves to support this project is at issue by some, however, better to have the possibility of excess take-away capacity than the alternative which has been so costly to Canadian producers.

Also on the regulatory front is the proposed merger of Nova Corporation, the intra-Alberta natural gas transmission system, with TransCanada PipeLines Limited. While posing some concerns for producers which need to be addressed, this combination also holds the potential for improvements in transportation cost efficiencies and seamless service for Alberta producers.

Additions to natural gas take-away capacity and the potential for transportation cost efficiencies bode well for natural gas pricing and net-backs. On a more speculative note, while El Niño has had a dampening effect on gas prices this past winter, there is the possibility of its antithesis, La Niña, as early as the coming winter season.

An important contrast between 1997 and 1998 are the effects which lower crude oil prices and less receptive capital markets will have on the cost structure of our industry. Over the past two years, strong commodity prices and robust capital markets combined to inflate the cost structure of essentially all the goods and services which support our industry. This environment also created another industry-wide problem – intense competition for a shortage of qualified technical staff. As a consequence, companies have had to continually address human resource issues in order to maintain a strong and stable knowledge base which is essential to the orderly exploitation of their assets. We see both the cost structure for goods and services and the competition for human resources easing in 1998 should the current environment persist.

Numac's Plans

Based on this outlook, the coming year will present new challenges and opportunities. In this environment, Numac's focus will be on capital spending efficiencies with the intent of maintaining expenditures for exploration and development activities substantially within cash flow expectations. Our capital budget for 1998, established in the fourth quarter of last year, has been reduced in response to

low crude oil prices and is now forecast at approximately \$124 million. Expenditures will focus on the natural gas and light gravity crude oil exploration and development opportunities described elsewhere in this report.

Spending on heavy oil activities, particularly our Manatokan project, is being severely curtailed, due to the impact that the deterioration of crude oil prices and differentials has had on heavy oil economics. The impact on Manatokan is exacerbated by the fact that production costs are high in the early stages of the project and, consequently, it has yet to generate positive cash flow. In response to the project's current economics, approximately 1,000 barrels per day of high-cost Manatokan oil production has been shut-in. It is possible, based upon continued close scrutiny of production costs and the outlook for heavy oil prices, that the project will be suspended pending an improvement in prices or technological advances that justify further investment.

It is our view that heavy oil will be the dominant source of crude oil production growth in western Canada and, therefore, it remains our intent to establish heavy oil as a core resource, as economics permit. The Manatoka property, with over four billion barrels of oil in place, will be the foundation for this strategy.

During 1997, Numac maintained an aggressive asset rationalization program to further improve its operating focus. As a consequence, the Company realized proceeds of \$85.5 million from non-core property sales initiated during the year. These dispositions accounted for 6.8 million barrels of proved oil equivalent reserves, approximately 2,700 barrels per day of oil and gas liquids production and approximately 11.5 million cubic feet per day of natural gas production.

Primarily as the result of the divestiture of non-core properties and the de-emphasis of heavy oil production, Numac's production volumes over the coming year will not be as strong as previously planned. Expectations are for 1998 production to average approximately 21,000 barrels of crude oil and natural gas liquids per day and 160 million cubic feet of natural gas per day. While the heavy oil production cutbacks will adversely impact volume statistics, they will, in the

current crude oil price environment, have a positive effect on cash flow. As a consequence of the lower component of heavy oil production, crude oil and liquids netbacks will reflect an improvement in the average price realized and a reduction in operating expenses per barrel of oil produced.

Going forward, we will continue to examine opportunities to further rationalize our asset base through the swap or sale of non-core properties. In particular, this aspect of our business will focus on the acquisition of assets which complement and expand our core growth areas and meet the objectives of our strategic plan. Given the current industry environment, this aspect of our strategy is expected to present a greater array of opportunities.

We will also continue to examine various opportunities that have the potential to provide step growth for your company. These include corporate acquisitions and, possibly, international initiatives. Any such initiatives will, however, be undertaken with a close eye on our balance sheet so as to maintain debt at sound multiples of cash flow.

The Board of Directors is pleased to acknowledge and thank Numac's management and staff for their contributions to the Company's success over the past year.

Of particular note, we wish to acknowledge the retirement of Mr. W.S. McGregor from the Board of Directors. Mr. McGregor was the founder and President of Numac Oil & Gas Ltd., a company which he established some 35 years ago, and is the namesake for Numac Energy which was created through the merger with Westcoast Petroleum. Throughout his distinguished career, Mr. McGregor has enjoyed an enviable reputation and, in 1997, was inducted into the Canadian Petroleum Hall of Fame in recognition of his outstanding contribution to the growth of the Canadian industry. We acknowledge, with sincere thanks, his considerable contributions and wish him the very best.

*On behalf of
the Board of Directors,*



Stewart D. McGregor
*Chairman and
Chief Executive Officer*

February 27, 1998

Key features of Numac's strategic plan include growth through the drill bit and focused capital spending, balanced for risk and reward.

NORTHEAST BRITISH COLUMBIA

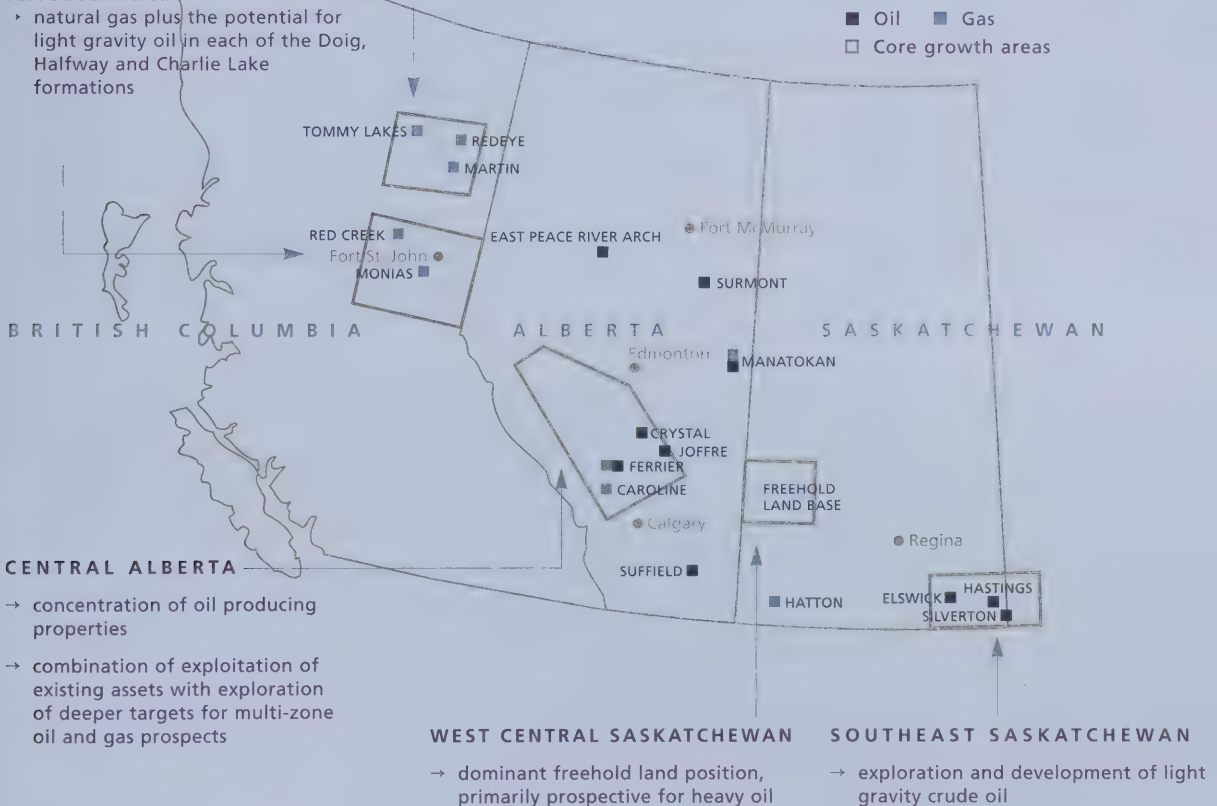
→ two primary focus areas:

Tommy Lakes/Martin Creek corridor

- ▶ shallow, medium-risk, multi-zone, liquids-rich natural gas opportunities

Fort St. John area

- ▶ natural gas plus the potential for light gravity oil in each of the Doig, Halfway and Charlie Lake formations



Consistent with the strategic plan, the major emphasis of exploration and development spending in 1997 remained on Numac's core growth areas. These areas, characterized by high working interests, dominant land positions, multi-zone exploration potential and opportunities to leverage off existing infrastructure, are shown on the map above. Capital spending will include an appropriate component of high impact exploration opportunities to drive accelerated growth.

KEY OPERATING STATISTICS AS AT DECEMBER 31, 1997

Landholdings

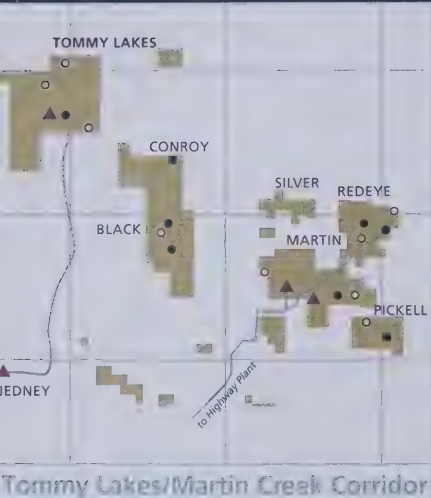
Exploratory → 434,600 net acres
 Developed → 113,000 net acres

Established Reserves

Oil and gas liquids → 4.8 Mmbbls
 (15.9 year life index)
 Natural gas → 272 Bcf
 (11.6 year life index)

1997 Production Exit Rates

Oil and gas liquids → 1,300 Bbls/day
 Natural gas → 77 Mmcf/day



In 1997, Numac's two core areas in northeast British Columbia accounted for approximately 46 percent of the Company's natural gas production and four percent of oil and gas liquids production.

To process our growing production in this region, Numac sponsored construction of additional deep-cut natural gas processing facilities at Jedney and Highway. These unregulated plants, which commenced operations in the third quarter of 1997, are expected to provide Numac with lower processing costs and improved gas liquids recovery.

Tommy Lakes/Martin Creek Corridor

Over the 1996/97 winter drilling season, Numac drilled 31 gross (19.6 net) wells in the Tommy Lakes/Martin Creek corridor with an 81 percent success rate, adding 27 million cubic feet of gas equivalent per day to production and in excess of 45 billion cubic feet of gas equivalent to reserves.

Plans for the 1997/98 winter season include:

- a four well drilling program at Tommy Lakes to further expand the reserve base. Two of these wells will be tied in by the second quarter of 1998 to add an estimated 3.5 million cubic feet per day to Numac's natural gas production;
- a seven well drilling program at Martin Creek and the tie-in of five gas wells drilled last winter. This program is expected to add up to nine million cubic feet per day of new gas production, further optimizing the facilities expansion completed in 1997;
- the drilling of up to four additional wells at Redeye, where the previous year's program delivered four new pools. In the fourth quarter of 1997, the installation of additional compression facilities raised Numac's new natural gas production at Redeye to 7.5 million cubic feet per day; and
- the drilling of three horizontal delineation wells at Black/Conroy to bring this potentially large resource play (20 billion cubic feet net to Numac) to commercial status by early 1999.

- BRITISH COLUMBIA
 FEATURE OF STRATEGIC IMPORTANCE**
- Numac's control over infrastructure
 - significant undeveloped landholdings with high potential exploration opportunities, including control over substantial on-land acreage between Red Creek and Caribou Creek which is prospective for light gravity crude oil in the Dalg formation
 - multi-zone, moderate-to-high gas property with low to moderate exploration risk and potential reserves in the range of two to four billion cubic feet of gas per well or 30 billion cubic feet of gas per prospect
 - a strong asset management team with extensive working knowledge of geological, transportation and marketing issues in the region

Fort St. John

The Fort St. John area is attractive for exploration due to multi-zone prospects, reasonable costs and mostly year-round access. Structural features in the region offer stacked prospective zones such as the Belloy, Halfway, Baldonnel and Cadomin, all within the same well. These zones can be either oil or liquids-rich natural gas bearing. Additional exploration potential lies within stratigraphic plays such as the Doig and Charlie Lake zones.

At Oak/Muskrat, seven wells have been drilled on former Wainoco lands where Numac holds interests ranging from 22 to 60 percent. Three of these wells have been cased for oil and one for gas. The most notable success was a horizontal well at Muskrat, placed on production at an initial rate of 600 barrels of oil per day (360 barrels per day net to Numac). Activity in 1998 will focus on a waterflood at Muskrat and a multi-well exploration program at both Oak and Muskrat.

As the result of impressive industry discoveries of light gravity crude oil in the Doig formation in the West Stoddart area, the Red Creek/West Stoddart/Cache Creek trend has emerged as one of the most prospective exploration plays in British Columbia.



Fort St. John Doig oil play

Reported production rates from successful wells in this play have exceeded 1,000 barrels per day. Land prices in the area have exceeded \$4,000 per acre. Through the Wainoco acquisition, Numac expanded its land base in the play to 25,000 net acres, extending from Monias to North Cache.

Numac's first exploration well in the play, drilled at Red Creek, encountered three prospective hydrocarbon zones, including the primary objective, the Doig sandstone. Upper zones in this well are currently being evaluated for tie-in to Numac's new raw gas gathering facilities in the area. The deeper Doig formation is being evaluated for oil production. The Company holds interests ranging from 50 to 100 percent in over 14,000 acres in

the vicinity of the discovery. Early evaluation of a recently completed 37 square mile 3-D seismic program in the Red Creek area has identified a number of additional locations for the 1998 drilling program. Numac holds a 100 percent interest in the new gas gathering and dehydration facilities at Red Creek which came on stream in mid-January, 1998 at a rate of four million cubic feet of gas per day.

KEY OPERATING STATISTICS AS AT DECEMBER 31, 1997

Landholdings

Exploratory → 582,800 net acres

Developed → 289,300 net acres

Established Reserves

Oil and gas liquids → 50.0 Mmbbls
(8.9 year life index)Natural gas → 239 Bcf
(10.1 year life index)

1997 Production Exit Rates

Oil and gas liquids → 15,400 Bbls/day

Natural gas → 66 Mmcf/day

CENTRAL ALBERTA
FEATURES OF STRATEGIC IMPORTANCE

- long life, low decline reserves of light gravity crude oil with premium oilfields
- multi-zone exploration/exploitation opportunities with an abundance of Company-controlled and industry infrastructure, and all season access
- secondary and tertiary recovery operations and opportunities
- high exploitation potential, employing advanced technologies such as Numac's CO₂ miscible flood at Joffre and a high resolution 3-D seismic program at Ferrier

central Alberta

This core area encompasses significant Numac producing properties, including Joffre, Crystal, Ferrier and Caroline.

Recent achievements and plans going forward include:

- a successful six well infill drilling program in the Crystal unit, combined with well workovers and waterflood rehabilitation, which has led to plans for a follow-up eight well program in 1998. Numac is operator and holds a 45 percent interest in the Crystal unit and substantial non-unit interests ranging from 75 to 100 percent;
- identification and evaluation of deeper sub-unit exploration prospects at Crystal and Ferrier for delineation and drilling in 1998; and
- excellent results from expansion of the tertiary CO₂ miscible flood program at Joffre. Project expansion through 1996 and 1997 included the development of three additional tertiary recovery patterns. At year-end 1997, production from the project had reached 660 barrels of light gravity crude oil per day, well above forecast levels. Numac has a 72 percent interest in the unit and holds significant additional non-unit lands amenable to CO₂ recovery within the Joffre field.

southern Alberta

On the Company's 30 percent-owned producing acreage at Suffield, in southern Alberta, significant reserve and production gains are being achieved through a combination of horizontal drilling, facilities debottlenecking and the expansion of fluid handling capabilities. The 1997 drilling program included 38 horizontal wells and eight horizontal re-entry wells. At year-end 1997, Numac's share of field production approximated 3,000 barrels of oil per day. However, given current heavy oil price differentials, production from higher-cost single well batteries at Suffield are being shut in, which will result in Numac's share of production in 1998 averaging an estimated 2,500 barrels per day.

north central Alberta

In other Alberta activity, Numac is expanding its natural gas production at Calling Lake in north central Alberta, where the Company currently produces four million cubic feet of gas per day. Numac controls 16,000 acres of undeveloped land in the area and a successful multi-well exploratory drilling program is expected to increase production to 10 million cubic feet of gas per day by 1998 year-end.

Manatokan heavy oil project

The cornerstone of Numac's heavy oil strategy is the Company's 100 percent-owned 61,600 acre heavy oil property at Manatokan in east central Alberta. This land base is estimated to contain in excess of four billion barrels of oil in place.

The aggressive pace of activity at Manatokan since Numac commenced commercial development early in 1996 has resulted in:

- completion of 42 vertical delineation wells and 97 slant hole development wells (drilled from multi-well pads);
- production growth to an average of 1,681 barrels of oil per day in 1997 and a year-end exit rate of 3,100 barrels per day; and
- construction of a 7,000 barrels per day central processing battery, which was commissioned late in 1997. A product pipeline connection, constructed by Husky Oil, commenced operations in February 1998. Located at the centre of a large oil sands region, the battery capacity is capable of processing both Numac and third party volumes.



- Numac lands
- multi-well pad sites
- processing battery (7,000 Bbls/day capacity)
- delineation wells

In 1997, regulatory approval was in place for pad drilling on reduced spacing on 16 sections (10,240 acres) of the Manatokan lands. In early 1998, following a protracted regulatory hearing process, approval was received for reduced spacing and pad drilling on an additional 50 sections (32,000 acres), which will allow pad drilling in the vicinity of some of the higher productivity wells located on the property. While not planned for 1998, future pad drilling in the vicinity of these wells is expected to have a significant positive impact on project economics.

Numac shares industry's confidence in the long-term benefits of heavy oil development, however, the recent sharp drop in oil prices has eroded near-term profitability. As a result, expansion of the Manatokan project in 1998 is being curtailed and, at this point, only those wells capable of recovering their variable costs of production will be produced. This has reduced the Company's 1998 production expectations at Manatokan to 2,200 barrels per day, down from an earlier forecast of 3,800 barrels per day. It is possible, based upon continued close scrutiny of production costs and the outlook for heavy oil prices, that the project will be suspended pending an improvement in prices or technological advances that justify further investment.

Surmont

At Surmont, located approximately 100 miles north of Manatokan in eastern Alberta, Numac retains a five percent net profits interest in a 134,000 acre oil sands lease farmed out to Gulf Canada. This interest is convertible to a 12.5 percent working interest in a commercial project. The property is estimated to contain 15.7 billion barrels of oil in place. A steam assisted gravity drainage ("SAGD") pilot project has been in operation at Surmont since August 1997. A commercial production decision is expected by year-end 1998. If successful, ultimate recoverable reserves exceed two billion barrels. Preliminary plans anticipate building the project in a series of phases. The first phase would commence operations in 2000 and reach a production level of 20,000 barrels per day by 2002. The timing of further phases would depend upon market conditions.

KEY OPERATING STATISTICS AS AT DECEMBER 31, 1997

Landholdings

Exploratory → 808,000 net acres

Developed → 79,700 net acres

Established Reserves

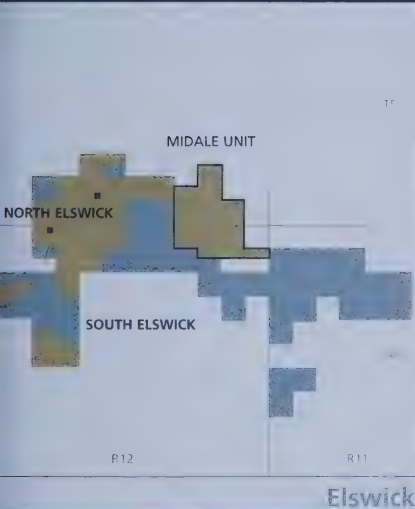
Oil and gas liquids → 14.2 Mmbbls
(8.9 year life index)

Natural gas → 43 Bcf
(10.1 year life index)

1997 Production Exit Rates

Oil and gas liquids → 4,400 Bbls/day

Natural gas → 12 Mmcf/day



In Saskatchewan, Numac has two distinct core areas:

- southeast Saskatchewan, where the Company has established a growing light gravity crude oil production base from a combination of new pool discoveries, acquisitions and successful exploitation. Principal producing areas include Elswick, Silverton, Hastings and Tatagwa; and
- west central Saskatchewan, where a dominant fee title land position was acquired late in 1996, in a region that has been an industry focal point for heavy oil and shallow gas exploration.

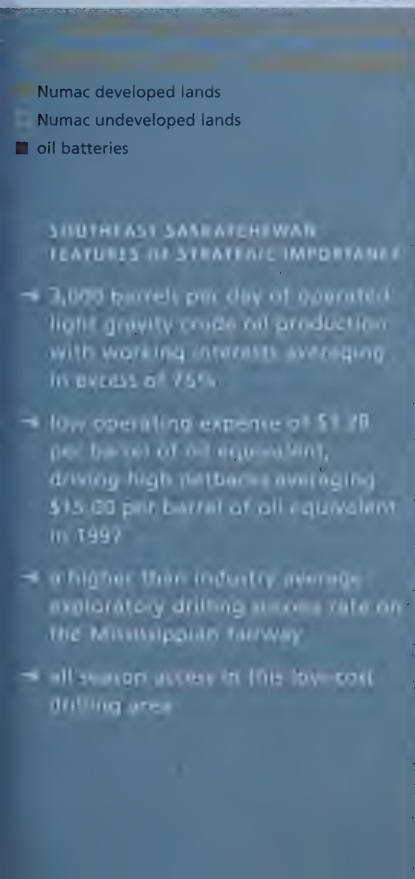
In addition, Numac has significant natural gas producing interests in the Hatton/Sandhills area of southwest Saskatchewan. Numac's total Saskatchewan production in 1997 represented approximately 21 percent of the Company's oil and gas liquids volumes and eight percent of natural gas volumes.

southeast Saskatchewan

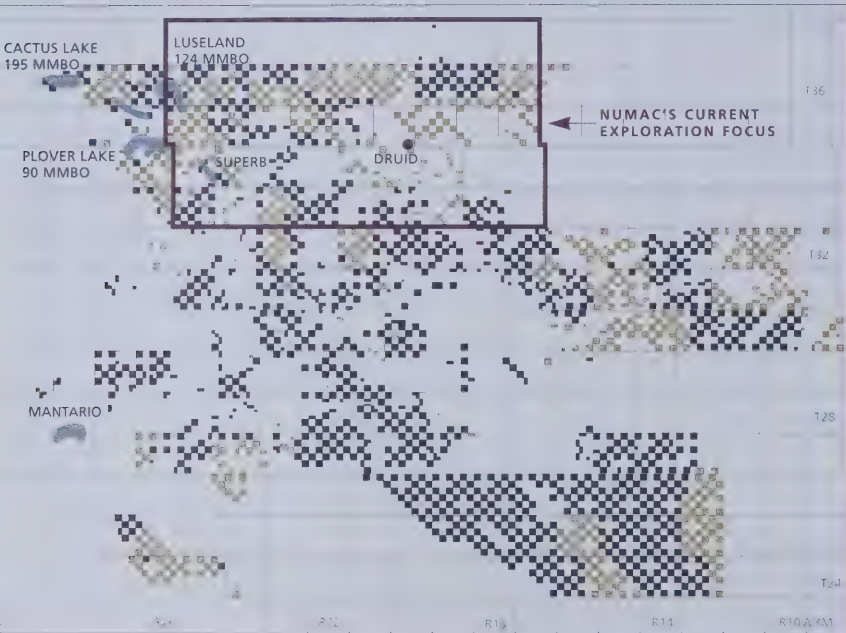
Recent achievements in this area include:

- horizontal drilling successes on 75 percent-owned acreage at Elswick that increased Numac's share of field production to 1,365 barrels per day in 1997 from 1,084 barrels per day in 1996;
- construction of waterflood facilities at South Elswick with injection scheduled to commence in the first half of 1998; and
- new pool discoveries at Hastings (100 percent working interest) and Carievale (50 percent working interest) that are currently under evaluation.

Additional exploration and development drilling is planned for southeast Saskatchewan in 1998, to further enhance our light gravity crude oil production base.



Numac's Saskatchewan properties provide a balance between light and heavy crude oil exploration and development opportunity.



west central Saskatchewan

- Numac exploration lands
- farmed-out lands
- Numac oil discovery
- producing oil fields

WEST CENTRAL SASKATCHEWAN FARMS OF STRATEGIC IMPORTANCE

- Includes 828,000 acres of freehold title land, a large portion of which is currently under farmout to two senior Canadian explorers (Canadian Occidental Petroleum and Gulf Canada) who have committed to spend \$25 million on these lands over the next two and one-half years.
- High netback royalty production from lands earned by the farmers.
- High internally-driven exploration and development programs on the lands which have reverted to Numac.

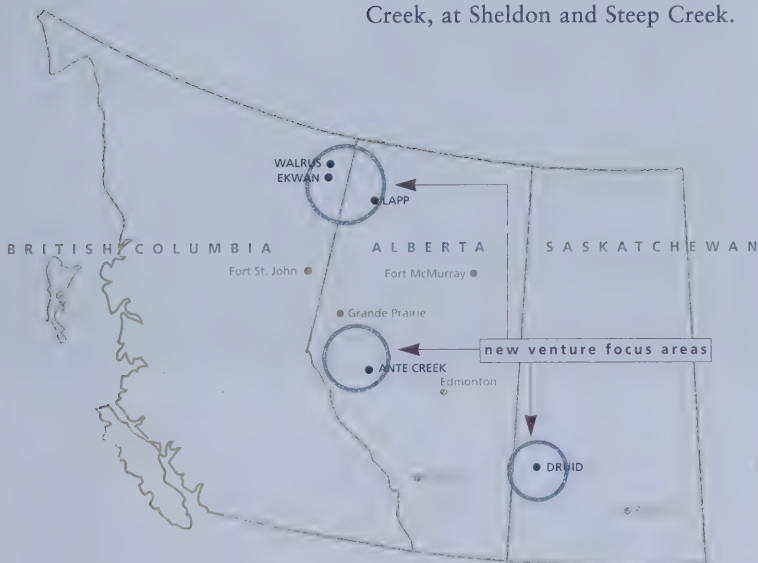
west central Saskatchewan

Each year, a portion of the lands not earned under the farmout agreement with Canadian Occidental and Gulf Canada revert to Numac. To date 251,000 acres have been returned pursuant to the mandatory relinquishment requirements of the agreement. Numac's initial exploration success on the relinquished lands includes a heavy oil discovery at Druid where evaluation of thick pay in the discovery well indicates an estimated 26 million barrels of oil in place per section. Numac has a 100 percent interest in this seven section play. The first development well is producing 65 barrels per day. Numac's discovery at Druid may lead to the opening of a new exploration trend on the Lloydminster formation. Drilling plans for 1998, which include up to 25 vertical and/or horizontal development wells and six exploration wells on the relinquished lands, are expected to deliver 900 barrels of oil per day. However, these plans are currently being re-examined in light of low field prices for heavy oil.

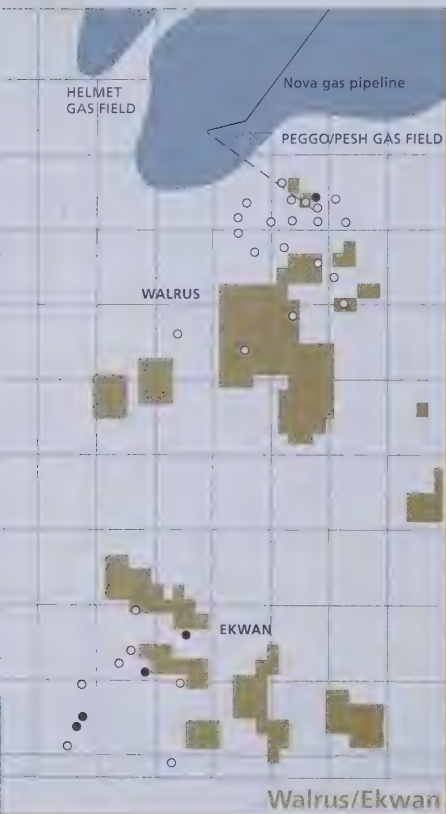
Internally-generated high impact exploration programs being pursued over the 1997/98 winter season include prospects in west central Alberta and northern British Columbia.

west central Alberta

In west central Alberta, the new venture program includes multi-zone Cretaceous and Triassic objectives at Ante Creek. Numac has recently cased an exploratory test that extends the newly discovered Ante Creek Triassic oil pool, where in-place reserves of light gravity crude oil exceed six million barrels per section. This well has been production tested with significant flow rates. Numac controls 16 sections in the area with approximately eight sections prospective for crude oil in the Triassic. An eight to 12 well program is contemplated for this area over the balance of 1998. In addition, the Triassic exploration program is continuing with Montney and Halfway formation tests to the north and west of Ante Creek, at Sheldon and Steep Creek.



Numac has established a large land base prospective for significant gas discovery in the Jean Marie formation.



northern British Columbia

In northern British Columbia the new venture program is targeting Devonian carbonate reservoirs in the Jean Marie formation. Initial industry discoveries include the North Helmet field with 217 billion cubic feet of recoverable gas reserves. The southward extension of the trend includes the 56 billion cubic feet Pesh/Peggo gas field. This field was recently extended further south with discoveries immediately north of Numac's Walrus area. These recent discoveries have been connected to the Nova gas system and are currently producing in the range of two to four million cubic feet per day per well. Nova is

extending its gathering system south to Walrus/Ekwan, where Numac and industry competitors have licensed 27 potential drilling locations. Numac operates in the Walrus/Ekwan area with interests exceeding 50 percent in 103,000 gross acres. In 1998 Numac intends to drill up to six vertical wells at Walrus and Ekwan to establish gas potential with a follow-up horizontal drilling and tie-in program contemplated for early 1999.

International

Negotiations with the government of Libya have resulted in a two year extension of the exploration agreement covering the 3.9 million acre block in which Numac holds a 7.5 percent interest. A one year extended production test from the D-1 discovery block commenced in December 1997 at an initial test rate of 5,700 barrels of oil per day. Exploration evaluation for the final two commitment wells continues.

Land

Numac's undeveloped Canadian land holdings, amounting to 2.2 million net acres at year-end 1997, were essentially unchanged from a year earlier. Net developed lands, totalling 482,000 acres, were up 20 percent, primarily as the result of the Wainoco acquisition and 1997 drilling activities, with some offset from property dispositions as the result of asset rationalization activity.

Land Holdings

at December 31, 1997 (in thousands of acres)	Developed		Undeveloped		Total	
	Gross	Net	Gross	Net	Gross	Net
Canada						
Alberta	709	289	1,032	583	1,741	872
British Columbia	217	113	801	435	1,018	548
Saskatchewan	284	80	858	808	1,142	888
Manitoba			398	398	398	398
Northwest Territories			74	2	74	2
East Coast			34	2	34	2
Total – 1997	1,210	482	3,197	2,228	4,407	2,710
– 1996	946	403	3,161	2,248	4,107	2,651
Libya – 1997 and 1996	–	–	3,934	295	3,934	295

Drilling

In 1997, reflecting the thrust of Numac's strategic plan, the Company drilled 173 net wells, up 47 percent from the previous year. The Company's average working interest in wells drilled also increased significantly to 64 percent from 42 percent in 1996.

The 1997 drilling program included 139 net oil wells and 23 net gas wells. Of the net oil wells, 93 were drilled on the Manatoka project and 16 on Numac's 30 percent-owned producing acreage at Suffield in southern Alberta. Of the gas wells, 15 were drilled in the Tommy Lakes/Martin Creek corridor of northeast British Columbia.

Wells Drilled

	Oil		Gas		Dry		Total	
	Gross	Net	Gross	Net	Gross	Net	Gross	Net
1997								
Exploration	8	6	11	7	12	9	31	22
Development	200	133	35	16	5	2	240	151
Total	208	139	46	23	17	11	271	173
Success rate							94%	94%
1996								
Exploration	3	1	11	6	11	6	25	13
Development	171	81	81	22	6	2	258	105
Total	174	82	92	28	17	8	283	118
Success rate							94%	93%

Year-end 1997 proved oil and gas liquids reserves, totalling 57.6 million barrels, were up 12 per cent from a year earlier, mainly as the result of the Company's delineation and development program at Manatokan, successful exploitation activity at Elswick and Suffield and the addition of new volumes from the Wainoco acquisition. Proved gas reserves, at 455 billion cubic feet, were up 17 percent, primarily reflecting the effects of the Wainoco acquisition and drilling successes at Martin Creek and Redeye in northeast British Columbia. On an oil equivalent basis, a net 25.4 million equivalent barrels were added to proved reserves, representing a 201 percent replacement of reserves produced, at a cost of \$9.97 per barrel of oil equivalent.

Net additions to proved plus probable reserves in 1997 totalled 31.7 million barrels of oil equivalent, representing a reserve replacement rate of 251 percent, and a reserve replacement cost of \$8.01 per barrel of oil equivalent. This replacement cost is down from the \$9.73 per barrel incurred in 1996, and significantly below the level of earlier years.

Summary of Oil and Gas Reserves

(before deduction of royalties)	Proved	Probable	Total
Crude Oil and Natural Gas Liquids (in thousands of barrels)			
December 31, 1996	51,459	18,973	70,432
Dispositions	(2,334)	(1,303)	(3,637)
Revisions	2,411	145	2,556
Acquisitions, extensions and discoveries	13,603	4,900	18,503
Production	(7,496)		(7,496)
December 31, 1997	57,643	22,715	80,358
Reserve Life Index (years)	7.7		10.7
Natural Gas (in billions of cubic feet)			
December 31, 1996	389.0	172.5	561.5
Dispositions	(21.3)	(16.0)	(37.3)
Revisions	(6.9)	2.2	(4.7)
Acquisitions, extensions and discoveries	145.6	38.8	184.4
Production	(51.4)		(51.4)
December 31, 1997	455.0	197.5	652.5
Reserve Life Index (years)	8.9		12.7

Estimated Present Worth of Net Pre-tax Cash Flow from Proven plus Probable⁽¹⁾ Reserves

(millions of dollars)	Undiscounted		Discounted	
		10%	15%	20%
December 31, 1997	\$ 1,605.1	\$ 859.6	\$ 696.6	\$ 586.1
December 31, 1996	\$ 1,391.4	\$ 740.6	\$ 602.6	\$ 509.5

⁽¹⁾ Probable reserves have been reduced by 50 percent to allow for risk.

Major Producing Properties

	1997			1996		
	Oil & NGL Bbls/day	Natural Gas Mmcf/day	BOE/day	Oil & NGL Bbls/day	Natural Gas Mmcf/day	BOE/day
Alberta						
Ferrier	2,156	9.0	3,056	2,309	11.7	3,479
Manatokan	1,681	7.8	2,461	233	9.8	1,213
Suffield	2,284	0.5	2,334	1,657	0.4	1,697
East Peace River Arch	2,515	1.2	2,635	3,234	2.1	3,444
Caroline	1,707	3.5	2,057	1,656	3.3	1,986
Grand Forks/Ronalane	1,322	0.1	1,332	1,832	—	1,832
Gold Creek	278	4.5	728	235	4.0	635
Crystal	532	0.9	622	667	1.1	777
Pine Creek	105	4.7	575	115	5.6	675
Calling Lake	—	4.7	470	—	5.3	530
Joffre	434	—	434	319	—	319
Progress	299	—	299	122	—	122
Wolf	—	2.5	250	—	1.4	140
Others	2,042	25.3	4,572	2,666	24.4	5,106
	15,355	64.7	21,825	15,045	69.1	21,955
British Columbia						
Tommy Lakes/Martin Creek	428	30.8	3,508	235	22.5	2,485
Monias	10	5.5	560	—	1.5	150
Sikanni	—	4.5	450	—	5.4	540
Red Creek	12	2.4	252	—	—	—
Others	379	21.2	2,499	52	18.7	1,922
	829	64.4	7,269	287	48.1	5,097
Saskatchewan						
Elswick	1,365	0.4	1,405	1,084	0.3	1,114
Hatton/Sandhills	—	10.2	1,020	—	10.5	1,050
Silverton/Carnduff	589	—	589	863	—	863
Arcola	405	—	405	441	—	441
Hastings	248	—	248	53	—	53
Wordsworth	224	—	224	365	—	365
Others	1,522	1.1	1,632	722	0.7	792
	4,353	11.7	5,523	3,528	11.5	4,678
Total production	20,537	140.8	34,617	18,860	128.7	31,730

Production

In 1997, Numac's crude oil and gas liquids production averaged 20,537 barrels per day and natural gas production averaged 140.8 million cubic feet per day, both nine percent higher than in the previous year. At year-end 1997, production exit rates were 21,100 barrels per day for oil and gas liquids and 155 million cubic feet per day for natural gas, up seven percent and 29 percent, respectively, from year-end 1996.

The production gains reflected a combination of success with the drill bit and the Wainoco acquisition. Significant contributions from drilling and development successes included crude oil increases at Manatokan and Suffield in Alberta and Elswick and Hastings in Saskatchewan, and a sharp increase in natural gas volumes in the Tommy Lakes/Martin Creek corridor in northeast British Columbia. Contributions from the Wainoco acquisition included natural gas volumes at Monias in British Columbia and Maple Glen in Alberta.

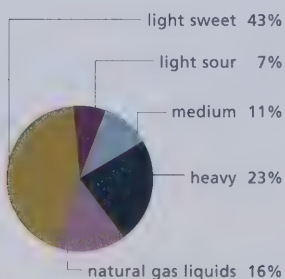
Marketing

Natural Gas

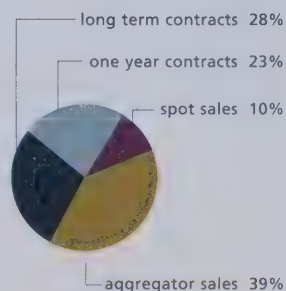
The integration of Wainoco's natural gas sales into Numac's portfolio during the second half of 1997 created a higher profile for the Company in British Columbia, as well as providing additional exposure into the U.S. northeast and midwest gas markets. Also during the latter part of 1997, Numac began processing the bulk of its British Columbia gas production through two new unregulated processing facilities at Highway and Jedney which are expected to result in more reliable service and improved liquids recoveries. In 1997, 46 percent of Numac's natural gas production originated in Alberta, 46 percent in British Columbia and eight percent in Saskatchewan.

Numac sells its gas to a diverse group of buyers. In 1997, approximately 39 percent was sold to aggregators, 51 percent was sold to term markets and the balance was sold into the day-to-day spot market. The average price realized by the Company for its natural gas production in 1997 was \$1.80 per thousand cubic feet, an increase of ten percent compared with \$1.64 in 1996. The increase resulted from much stronger prices in British Columbia and an improvement in Alberta prices. Numac calculates its Alberta and Saskatchewan prices at the plant gate and British Columbia prices at the wellhead, which are net of gathering and processing costs. NYMEX prices were also stronger in 1997 compared with 1996. Approximately 62 percent of Numac's total gas sales are tied to U.S. prices.

1997 crude oil and gas liquids production



1997 natural gas sales



Over the past few years, increasing production in Canada, combined with limited export pipeline capacity has constrained Canadian gas prices, and this is expected to continue over the short-term. However, expansion of the Northern Border and TransCanada pipelines in late 1998 will permit more gas to flow out of Alberta, thereby strengthening prices. With additional pipeline capacity anticipated in the 1999-2000 time frame, such as the proposed Alliance Pipeline, there should be a basis for stronger natural gas prices at that time.

In the 1996/97 contract year, Numac left a large portion of its natural gas production unhedged, thereby realizing the higher market prices. Going forward, Numac has hedged one half of its British Columbia production for the 1997/98 winter months and one half of its Alberta production for the winter and ensuing summer months, in the expectation of soft gas prices. As well, Numac has made a decision to hedge some of its U.S. gas transportation beginning November 1998 in anticipation of stronger prices in Alberta relative to prices in the U.S. midwest. Weaker U.S. midwest prices are expected in the initial years of pipeline expansions to this market.

Crude Oil and Natural Gas Liquids

Numac has a favorable crude oil production mix, the major portion of which, in 1997, was composed primarily of light and medium quality crudes. Numac sells its crude oil to various refineries, using a mix of spot and term sales to maximize netbacks. During 1997, long-term transportation and markets were secured for the Company's heavy crude oil production from Manatokan. Additionally, through the acquisition of the Wainoco assets, Numac established a presence in the British Columbia crude oil market. The majority of the Company's 1997 natural gas liquids production was sold to a single buyer under a multi-year arrangement.

The average price realized by Numac for its crude oil and natural gas liquids production in 1997 was \$21.96 per barrel, compared with \$23.59 per barrel in the previous year. The decline reflected generally lower crude oil prices on world markets, a slightly higher proportion of heavy crude oil in Numac's production mix and hedging costs.

Health, Safety and the Environment

Numac's commitment to health, safety and the environment is an essential part of the Company's planning process, not only because the Company is keenly aware of its responsibilities but because it makes good business sense. Appropriate policies and guiding principles have been approved by the Board of Directors, and periodic audits are carried out to ensure compliance with prescribed policies, procedures and regulatory requirements. All of our operations meet or exceed required regulatory and industry environmental, health and safety standards. Notable safety achievements by Numac employees at year-end 1997 included over three million kilometers of driving with only one minor preventable vehicle accident, and 875,000 hours worked since the last lost-time accident in January 1996. The Company is also an active participant in a number of industry and government initiatives targeting further improvements in health and safety and protection of the environment. In 1997, as a supporter of the federal government's "Voluntary Challenge on Climate Change," Numac completed and submitted to government the action plan the Company will be pursuing. Through this initiative, Numac will continue to promote energy conservation and efficiency, and the reduction of greenhouse gases. Given the increasing accountability required of corporations with regard to health, safety and the environment, Numac seeks to be forward looking and proactive in its response to such issues.

management's discussion and analysis

This section should be read in
conjunction with the Consolidated
Financial Statements and Notes thereto
included in this Annual Report.

Results of Operations

for the years ended December 31, 1997 and 1996

Overview

Fiscal 1997 has been a year of strong performance for Numac in several key areas. Increased emphasis on the Company's core areas and an active acquisition program have resulted in total production increases of 9% over 1996. This, combined with stronger natural gas prices, has resulted in increased total cash flow as well as cash flow per share. Numac continued to focus on core growth areas, which involved a much expanded capital program for 1997, the acquisition of the Canadian oil and gas assets of Wainoco Oil Corporation, and dispositions of non-core, low working interest properties. This increased focus has also resulted in higher reserve additions, as well as reduced reserve replacement costs.

Funds from Operations and Net Income

Funds from operations for 1997 were \$128.2 million (\$1.33 per share), compared to \$122.1 million (\$1.30 per share) in 1996. This 5% increase was primarily attributable to higher natural gas revenues due to increased production volumes and strong prices. Crude oil revenues also contributed to improved cash flow, although increased volumes were partially offset by lower prices.

Numac reported net income of \$12.6 million (\$0.13 per share) compared to \$16.9 million (\$0.18 per share) in 1996. Earnings were lower in 1997 as a result of the increase in crude oil and natural gas revenues being more than offset by higher depletion and depreciation expense and higher operating costs associated with the advancement of the Company's Manatoka heavy oil project.

Crude Oil and Natural Gas Liquids

Gross revenue for crude oil and natural gas liquids sales increased to \$164.6 million, compared with \$162.8 million in 1996. The moderate improvement was due to a 9% increase in production volumes which averaged 20,537 Bbbls/day compared to 18,860 Bbbls/day in 1996. This increase was due primarily to production growth at Manatoka and Suffield, Alberta, and Elswick and Hastings in Saskatchewan. Crude oil and liquids production volumes continued to increase at year end resulting in a 1997 exit production rate of 21,100 Bbbls/day compared to the 1996 exit production rate of 19,800 Bbbls/day. The 1997 exit rate includes the impact of the divestiture of non-core properties representing production of 1,400 Bbbls/day. Production gains were offset by a 7% decrease in the average selling price per barrel to \$21.96 in 1997 compared to \$23.59 in 1996. The prior fiscal year experienced high crude oil prices, particularly in the fourth quarter, which averaged \$25.38/Bbl, compared with \$20.22/Bbl in the fourth quarter of 1997.

Natural Gas

Natural gas revenue in 1997 increased 20% to \$92.5 million, compared with \$77.2 million in the prior year. This increase was due to both higher production volumes and stronger natural gas prices. Production volumes averaged 140.8 Mmcf/day in 1997, an increase of 9% compared to 128.7 Mmcf/day in 1996. This increase was primarily due to additional production from northeast British Columbia gas fields as well as the new Wainoco volumes acquired in June 1997. Natural gas production continually improved throughout the year with an exit rate in 1997 of 155 Mmcf/day, a 29% increase over the exit rate of 120 Mmcf/day in 1996. Natural gas prices remained strong during the winter months resulting in an annual average price of \$1.80/Mcf in 1997, a 10% increase over \$1.64/Mcf in 1996.

Royalties

Total royalties (net of Alberta Royalty Tax Credit) decreased during the year from \$4.10/BOE or 19.8% of sales in 1996 to \$3.51/BOE or 17.2% in 1997. The royalties paid on oil production decreased from 22.5% in 1996 to 19.4% in 1997 due to the decrease in average prices realized on crude oil and liquids production. Natural gas royalties decreased to 13.3% in 1997 compared to 14.0% in 1996. This decrease was due to a \$2.8 million refund of royalties pursuant to Alberta royalty simplification. Excluding this refund, the royalty rate for 1997 would have increased to 16.1% because of stronger average natural gas prices realized during the year.

	1997	1996
Average royalty cost (after ARTC)		
Oil and liquids (\$/Bbl)	\$ 4.27	\$ 5.31
Natural gas (\$/Mcf)	\$ 0.24	\$ 0.23
Total (\$/BOE)	\$ 3.51	\$ 4.10

Other Income

During 1997, other income remained relatively stable at \$1.8 million, compared to \$1.9 million in 1996. Other income consisted primarily of \$1.4 million relating to revenue generated from Numac's natural gas storage program.

Operating Expense

Operating expense increased by 38% to \$63.0 million in 1997 from \$45.6 million in 1996 due to an increase in operating costs per BOE, and a 9% increase in production volumes. Natural gas operating costs remained constant from 1996 at \$0.39/Mcf while crude oil and liquids operating costs increased from \$3.92/Bbl in 1996 to \$5.74/Bbl in 1997. This increase is primarily attributable to startup costs associated with the Company's increasing heavy oil production at Manatokan.

	1997	1996
Oil and liquids (\$/Bbl)	\$ 5.74	\$ 3.92
Natural gas (\$/Mcf)	\$ 0.39	\$ 0.39
Total (\$/BOE)	\$ 4.98	\$ 3.92

netbacks
(\$/BOE)



general and
administrative expense
(\$/BOE)



gas prices
(\$/Mcf)



oil prices
(\$/Bbl)



Netbacks

Netbacks on a barrel of oil equivalent basis decreased by 6% from \$12.65/BOE in 1996 to \$11.86/BOE in 1997. This decrease is attributable to reduced netbacks on oil production due to lower average realized prices and higher operating costs per barrel, partially offset by lower royalties. However, reduced oil netbacks were partially offset by higher natural gas netbacks as a result of stronger prices.

	1997	1996
Oil and liquids (\$/Bbl)		
Revenues	\$ 21.96	\$ 23.59
Royalties	(4.27)	(5.31)
Operating costs	(5.74)	(3.92)
	<u>\$ 11.95</u>	<u>\$ 14.36</u>
Natural gas (\$/Mcf)		
Revenues	\$ 1.80	\$ 1.64
Royalties	(0.24)	(0.23)
Operating costs	(0.39)	(0.39)
	<u>\$ 1.17</u>	<u>\$ 1.02</u>
Total (\$/BOE)		
Revenues	\$ 20.35	\$ 20.67
Royalties	(3.51)	(4.10)
Operating costs	(4.98)	(3.92)
	<u>\$ 11.86</u>	<u>\$ 12.65</u>

General and Administrative Expense

General and administrative expense was \$7.1 million in 1997, a decrease of 24% from \$9.4 million in 1996. General and administrative expense was \$0.56/BOE in 1997, a reduction of 31% as compared to \$0.81/BOE in 1996. The decline was primarily caused by a decrease in gross G&A expenditures and a \$1.1 million increase in overhead recoveries due to the expanded 1997 capital expenditure program. There were 242 permanent employees at December 31, 1997, compared to 211 employees at December 31, 1996. This increase is primarily due to the acquisition of Wainoco assets, as well as the expanded 1997 capital program.

Interest on Long-term Debt

Interest on debt increased to \$15.6 million in 1997, compared to \$12.6 million in 1996. The increase is a result of issuing an additional \$119.6 million in debt to finance the acquisition of the Canadian oil and gas assets of Wainoco Oil Corporation. In December 1997, \$47.9 million of this debt was repaid with proceeds from property divestitures. The average rate of interest paid on Numac's long-term debt dropped to 6.0% in 1997 from 6.5% in 1996. Interest coverage was 9.2 times in 1997, compared to 10.7 times in 1996.

Depletion, Depreciation and Future Site Restoration

Depletion and depreciation charges increased to \$90.3 million in 1997 compared to \$74.7 million in 1996. Approximately half of the increase relates to higher crude oil and natural gas production during the year. The remaining variance is due to the depletion and depreciation rate which increased to \$5.39/BOE, as compared to \$4.83/BOE in 1996 as a result of a 51% increase in the capital program in 1997 compared to 1996.

Future site restoration expense decreased to \$4.5 million in 1997, compared to \$4.7 million in 1996. A reassessment of estimated future site restoration costs resulted in a reduction in the site restoration rate from \$0.32/BOE in 1996 to \$0.28/BOE in 1997. Approximately \$0.8 million of costs incurred for site reclamation during 1997 were charged against the accumulated provision (1996 – \$1.2 million).

Income and Other Taxes

Numac's provision for the federal Large Corporations Tax and Saskatchewan Resource Surcharge remained relatively constant at \$2.7 million, compared to \$3.0 million in 1996.

The Company recorded a deferred tax provision of \$18.8 million in 1997, compared to \$27.4 million in 1996, as a result of lower income before taxes. The Company's effective income tax rate differs from the legislated tax rate of 44.9% principally as a result of non-deductible depletion and depreciation on assets that have no corresponding tax basis. These assets will be depleted and depreciated at the Company's normal annual rates and, accordingly, will have a similar impact on future effective tax rates.

Numac does not expect to pay current income tax in 1998 or 1999 (other than the federal Large Corporations Tax and Saskatchewan Resource Surcharge) as the Company's tax pools, combined with 1998 capital expenditures, are sufficient to shelter anticipated cash flow.

At December 31, Numac's estimated tax pool balances were as follows:

(\$ millions)	1997	1996
Canadian oil and gas property expense	\$ 191.8	\$ 96.8
Undepreciated capital cost	153.6	111.9
Canadian development expense	89.9	57.7
Canadian exploration expense	80.7	87.5
Foreign exploration and development expense	23.5	23.4
Earned depletion base and other	17.2	15.3
Attributed Canadian royalty income deduction	43.8	28.3
	\$ 600.5	\$ 420.9

During the year, tax pools of \$192 million were obtained from the acquisition of the Canadian oil and gas assets of Wainoco Oil Corporation.

Liquidity and Capital Resources

Numac's net capital expenditures for 1997 totaled \$254.3 million, an increase of 51% over 1996 capital spending of \$168.3 million. Total exploration and development expenditures increased 63% from \$106.3 million in 1996 to \$173.4 million in 1997, primarily due to expanded development activities. Significant expenditures were incurred on heavy oil development at Manatokan and Suffield as well as on natural gas properties in northeast British Columbia.

During the year Numac continued its asset rationalization program with the objective of consolidating interests in core areas. On June 16, 1997, Numac completed the acquisition of the Canadian oil and gas assets of Wainoco Oil Corporation for cash consideration of \$131.9 million. The purchase was partially financed through the issuance of Canadian debt of \$119.6 million. As well, Numac sold non-core, low working interest properties for proceeds of \$85.5 million. By year end, \$60.1 million had been received from the divestitures. The remaining proceeds associated with property disposals of \$25.4 million were received in January 1998.

The following table summarizes Numac's capital expenditures:

(\$ thousands)	1997	1996
Land acquisitions and retention	\$ 13,506	\$ 15,731
Exploration	26,084	25,595
Development	130,554	63,125
International	1,574	605
Other	1,653	1,271
Total exploration and development expenditures	173,371	106,327
Producing property acquisitions	9,190	35,137
Acquisition of Wainoco assets	131,881	-
Acquisition of Smart On Resources Inc.	-	51,251
Proceeds on sale of property	(60,099)	(24,373)
Net acquisitions	80,972	62,015
Net capital expenditures	\$ 254,343	\$ 168,342

Proved plus probable reserve additions through development and net acquisitions in 1997 totalled 31.8 MMBOE, almost double the 17.3 MMBOE of reserve additions in 1996. This resulted in a reserve replacement ratio of 251% for 1997 compared to 149% in 1996. Reserve replacement costs on a proved basis for 1997 were \$9.97/BOE, compared to \$10.30/BOE in 1996. The reserve replacement costs on a proved plus probable basis also improved considerably at \$8.01/BOE, an 18% reduction from \$9.73/BOE in 1996.

The Company has extended its Normal Course Issuer Bid as it feels that the current market price of the Company's common shares does not reflect their value. Effective December 19, 1997 and terminating on December 18, 1998, the Company may purchase, from time to time, up to 5% of its issued and outstanding common shares on the open market. During 1997, the Company expended \$7.3 million to purchase 1,297,681 common shares at an average cost of \$5.61 per share. During 1996, the Company expended \$0.7 million to purchase 118,600 common shares at an average cost of \$5.53 per share.

Numac's 1997 capital program and issuer bid were financed through a combination of funds from operations, issuance of long-term debt, decreases in net working capital, and existing cash balances.

(\$ thousands)	1997	1996
Uses of funds:		
Net capital expenditures	\$ 254,343	\$ 168,342
Normal Course Issuer Bid	7,279	656
	\$ 261,622	\$ 168,998
Sources of funds:		
Funds from operations	\$ 128,196	\$ 122,058
Increase (decrease) in long-term debt	71,409	(26)
Decrease in cash	44,025	6,540
Decrease in net working capital	17,653	18,293
Issue of common shares	339	22,133
	\$ 261,622	\$ 168,998

Numac has an unsecured credit facility with two Canadian chartered banks. The previous year's \$225 million production loan facility has been renegotiated and the Company now has a \$310 million revolving loan and a \$30 million operating loan. The revolving loan may be extended annually at the option of the banks or converted to a term loan and repaid in equal payments over five years. The effective rate of interest on the long-term debt averaged approximately 6.0% for 1997, due to the lower average rates on the new debt issued, compared with 6.5% in 1996. At December 31, 1997, the Company had unutilized lines of credit of approximately \$100 million.

	1997	1996
Net debt to debt plus equity	0.4	0.3
Net debt to cash flow	2.2	1.3

Both net debt to debt plus equity and to cash flow increased at December 31, 1997, compared to December 31, 1996. This change is due to increased debt to finance the expanded 1997 capital program.

Cash generated from operations, combined with the unused lines of credit, will continue to provide the Company with flexibility to pursue growth opportunities consistent with the Company's long-term strategic plan.

General

Profitability within the oil and gas industry is dependent to a large extent on prices received for crude oil and natural gas. Prices of these commodities are influenced by supply and demand factors including the level of industry drilling activity, transportation availability, weather conditions, state of the economy, and international political developments.

The costs associated with the Company's exploration and development activities are also influenced by commodity prices. When commodity prices are high, activity levels within the industry tend to increase, resulting in upward pressure on land prices and equipment and service costs.

The oil and gas industry is subject to environmental regulations pursuant to provincial and federal legislation. Environmental legislation provides for restrictions and prohibitions on releases of emissions of various substances produced in association with certain crude oil and natural gas operations. In addition, legislation requires that well and facility sites be abandoned and reclaimed to the satisfaction of provincial authorities. The industry is also faced with uncertainties as to availability of access to environmentally sensitive lands for exploration and development activities.

Risk Management

The principal risk for the Company is its ability to discover and produce reserves at a cost that provides an acceptable rate of return on investment. The Company attempts to balance its prospect portfolio between high and low risk exploration, development and acquisition opportunities. New technology, such as horizontal drilling, and advanced geophysical modeling techniques, are being used in those areas where it is commercially practical.

Numac's comprehensive insurance program protects the Company against certain potentially significant losses which could arise as a result of the risks associated with the exploration, development and production of crude oil and natural gas. Numac has developed its own specific environmental and operating guidelines, a comprehensive emergency response program and a spill reporting system. Numac also maintains a comprehensive safety program which is designed to encourage employees' and contractors' responsibility and participation in all aspects of operations. The Company believes that it is in substantial compliance, in all material respects, with all current environmental legislation and is taking such steps as the Company believes are prudent to ensure that compliance will be maintained.

The primary source of funding for the Company's capital program is cash flow from operations. In order to protect cash flow and capital programs, the Company uses financial derivative swaps with off-balance sheet risk to manage its exposure to fluctuations in crude oil and natural gas prices, foreign exchange rates, and interest rates.

Market risk is the possibility that a change in crude oil and natural gas prices, foreign currency exchange rates, or interest rates will cause the value of a financial instrument to decrease or become more costly to settle. Financial instruments consist of substantially all current assets and liabilities, long-term debt, as well as financial derivative swaps. The Company uses financial derivative swaps for the purpose of hedging, and accordingly, reduces exposure to significant market risk because gains and losses on the financial swaps are offset by gains and losses on production revenue, interest expense or the specific transaction being hedged.

The Company uses fixed price contracts and swaps to hedge its exposure to fluctuations in crude oil and natural gas prices, foreign exchange forward rate contracts to reduce exposure to fluctuating foreign exchange rates, and interest rate forward contracts to vary the amounts and periods for which interest rates on borrowings are fixed. The Company enters into swap contracts from time to time to fix natural gas and crude oil prices, natural gas basis differentials and crude oil quality differentials, US\$/CDN\$ exchange rates and interest rates. A swap is a financial derivative instrument whereby the Company and a third party agree to settle, at specified intervals, the difference between an agreed fixed commodity price, interest rate or exchange rate and floating prices or rates calculated by reference to an agreed notional volume or principal amount. There is no obligation to deliver or receive quantities of crude oil or natural gas pursuant to a swap contract.

Certain of the Company's natural gas sales contracts incorporate prices which are indexed to the New York Mercantile Exchange ("NYMEX") natural gas futures contracts. The Company also enters into contracts which incorporate prices indexed to various trading and delivery points such as Sumas, Washington and Empress, Alberta. Natural gas sold in the Sumas and Empress markets is typically priced at a discount to NYMEX prices with the differential reflecting supply and demand fundamentals combined with transportation charges to the different markets.

The price the Company receives for its crude oil production is indexed to NYMEX West Texas Intermediate ("WTI") crude oil futures contracts less a quality, transportation and foreign exchange differential. Each of these price elements is subject to volatility caused by the market's changing views of supply and demand fundamentals.

The natural gas and crude oil pricing mechanisms described above generally utilize price indexes which are denominated in US\$. This results in the Company's revenue streams being subject to fluctuation in the US\$/CDN\$ exchange rate.

The Company's bank borrowings are currently subject to floating short-term market rates thus exposing financing costs and cash flow to the volatility of the debt markets.

To mitigate the cash flow impact of adverse changes in commodity prices, foreign currency exchange rates and interest rates, the Company had derivative hedging positions in place at December 31, 1997, as disclosed in Note 7 to the consolidated financial statements.

In addition to market risk, the financial instruments of the Company involve, to varying degrees, credit risk. A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal credit risks. The Company is also exposed to credit risk associated with possible non-performance by counterparties to swap agreements. The Company minimizes credit risk associated with swap agreements by entering into contracts with only highly rated financial institutions, and controls counterparty credit risk with credit approvals, limits on exposures to any one counterparty, and monitoring procedures. The Company does not require collateral nor other security to support financial instruments nor does the Company provide collateral or security to counterparties. The Company does not expect non-performance by any counterparty.

The Board of Directors has established limits on the nature and amount of hedging contracts that the Company can enter into, and receives periodic updates on the status of all hedging activities. The Company also maintains a system of internal controls designed specifically to prevent undue risk being undertaken by the Company when using financial instruments.

Year 2000

The Year 2000 issue refers to diverse business implications associated with computer systems, applications, and various equipment that typically use only the last two digits of a given year as a date reference. On January 1, 2000, it is anticipated that many computer based systems could fail or provide inaccurate information. It is further possible that many systems and equipment may start failing prior to the Year 2000. Such potential problems could range from minor processing difficulties to complete system and equipment malfunctions. These failures are not only limited to computer hardware and software, but also include plants, field equipment, machinery, office equipment, elevators, telephone systems, and security systems. The Year 2000 issue may affect organizations around the globe, with estimated prevention and remediation costs in the billions of dollars. To minimize the Company's risk, Numac Energy initiated a Year 2000 project in January 1998 to assess its exposure and the cost of necessary remedial action.

This project includes an extensive assessment of Numac's automation and third party interactions, an estimate of the effort required to address any issues, followed by a program of repair, replacement, or retirement of items that may be affected, prior to the end of the first quarter of 1999. All new equipment and systems will be evaluated for Year 2000 compliance prior to acquisition to prevent additional exposure.

While the assessment has just begun, Numac's computer systems vulnerability does not appear to be high due to previously adopted maintenance programs and extensive usage of packaged software from third parties. Most of these third party suppliers provide Year 2000 compliant versions, or are in the process of providing upgrades to current products. Resources and costs associated with a corrective action program for currently known deficiencies have been estimated at approximately \$0.4 million for 1998 including assessment costs and replacement of hardware and systems. The Company is currently evaluating field operations and equipment for Year 2000 compliance. While initial reviews indicate there will be field deficiencies, it does not appear that such items will be excessive. When the assessment is completed, an action plan will be prepared and implemented to resolve any inadequacies on a timely basis. Numac will expense all Year 2000 expenditures that do not result in any future benefits to the Company. Continuous testing, suppliers' warranty certification, and other due diligence work will continue throughout 1998, and required changes carefully managed to minimize impact to the business.

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Over the near term, world oil prices may remain weak, mainly due to increased production from OPEC nations and reduced demand from key industrialized Asian countries. Price improvements will largely depend upon the pace of economic recovery in Asia. For Canadian heavy crude oil, the downward pressure on prices is compounded by the effects of insufficient upgrading capacity. Over the spring and summer months, with an anticipated increase in demand for heavy crude oil as a road-making feedstock, quality differentials are expected to narrow, but a sustainable improvement in heavy oil prices cannot be expected until significant additional upgrading capacity becomes available.

Over the next one to three years, the outlook for Canadian natural gas is bullish, as 2.3 billion cubic feet per day of planned additional export pipeline capacity is scheduled to come on-stream in late 1998 and 1999. The increase in export volumes is expected to remove the surplus supply currently overhanging the Canadian market and result in Canadian prices moving closer to parity with those in the higher-priced United States market, subject to transportation adjustments.

Given currently depressed oil prices, however, Numac's near-term plans will focus on maintaining expenditures for exploration and development activities substantially within cash flow expectations. The Company's capital budget for 1998, established in the fourth quarter of last year, has been reduced to \$124 million in response to the lower crude oil price environment.

Capital expenditures will be directed, primarily, towards natural gas and light gravity crude oil exploration and development opportunities in core growth areas. These include: the Tommy Lakes/Martin Creek corridor in northeast British Columbia, largely to expand Numac's natural gas reserves and production base in the region; Red Creek, in the vicinity of Fort St. John, also in northeast British Columbia, where the Company has plans for a significant exploration and development program on the Doig light gravity crude oil play; and projects in Alberta and Saskatchewan, principally light gravity crude oil exploitation and development opportunities at Ferrier and Crystal in central Alberta and Elswick in southeast Saskatchewan. The exploration component of the capital program includes further evaluation of high impact natural gas prospects in the Walrus/Ekwan area of northern British Columbia, and oil and gas prospects at Ante Creek in west central Alberta. Spending on heavy oil activities, particularly our Manatokan project, is being severely curtailed due to the impact that the deterioration in crude oil prices and differentials has had on heavy oil economics. In addition, in response to these economics, approximately 1,000 barrels per day of higher cost Manatokan oil production has been shut-in. It is possible, based upon continued close scrutiny of production costs and the outlook for heavy oil prices, that the Manatokan project will be suspended pending an improvement in prices or technological advances that justify further investment.

As the result of the de-emphasis on heavy oil initiatives, approximately 3,000 barrels per day will be eliminated from Numac's earlier crude oil production expectations. The Company's revised forecast is for 1998 oil and gas liquids production to average approximately 21,000 barrels per day and natural gas production to average 160 million cubic feet per day. While the heavy oil cutbacks adversely impact Numac's volume statistics, they do, in fact, have a positive effect on cash flow. Anticipated netbacks in 1998 will reflect improvements in both the average price realized and operating expense per barrel of oil produced due to the lower component of heavy oil production.

The main factors affecting Numac's funds from operations are crude oil and natural gas prices, production volumes, and the US\$/CDN\$ exchange rate. The sensitivities of funds from operations to changes in these factors is shown in the following table, based on 1998 forecast activity levels. The impact of a change in any one factor may be compounded or offset by changes in other factors. This table does not consider the impact of any interrelationship between the factors or the Company's hedging activities.

Factor	1998 Forecast Average	Increase (Decrease)	Approximate Annual Increase in Funds from Operations (Cdn\$ millions)
Price of crude oil			
(West Texas Intermediate) (US\$/Bbl)	US\$18.00	US\$1.00	\$9.0
Price of natural gas (CDN\$/Mcf)	\$1.70	\$0.10	\$4.9
Production of crude oil and natural gas liquids (Bbls/day)	21,000	1,000	\$3.5
Production of natural gas (Mmcf/day)	160	10	\$3.9
US\$/CDN\$ exchange rate	US\$0.70	US\$(0.01)	\$2.5

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of Numac Energy Inc. are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada, and include certain amounts that reflect management's judgement and best estimates. Financial information contained elsewhere in the Annual Report is consistent with the information contained in the consolidated financial statements.

The management of the Company maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are relevant, reliable and accurate for the preparation of consolidated financial statements and that assets are properly accounted for and adequately safeguarded.

The internal accounting control process includes management's communications to employees of policies which govern ethical business conduct.

The Board of Directors carries out its responsibility for financial reporting and internal controls principally through its Audit Committee, which is comprised of directors who are not officers or employees of the Company. The Committee meets regularly with management, the internal auditors, and the external auditors to discuss and review the consolidated financial statements, internal controls, audit reports, and accounting policies.

The consolidated financial statements have been audited by Price Waterhouse, who have been appointed by the shareholders as the Company's independent auditors, and their report follows.

Stewart D. McGregor
Chairman and
Chief Executive Officer
February 27, 1998

Dale J. Hohm
Vice-President, Finance
and Corporate Secretary

To the Shareholders of Numac Energy Inc.

We have audited the accompanying balance sheets of Numac Energy Inc. as at December 31, 1997 and 1996, and the consolidated statements of income and deficit and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. These standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. We also assess the accounting principles used and our significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in Canada.

Canary, Canada
January 19, 1998

Chartered Accountants

consolidated financial statements

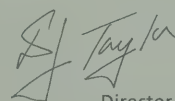
Consolidated Balance Sheets

December 31 (\$ thousands)	1997	1996
Assets		
Current Assets		
Cash and temporary cash investments	\$ 3,063	\$ 47,088
Accounts receivable	42,024	44,643
Assets held for sale	25,400	—
	70,487	91,731
Property, plant and equipment (Notes 2 and 3)	736,488	597,865
	<u>\$ 806,975</u>	<u>\$ 689,596</u>
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 79,399	\$ 61,365
Long-term debt (Note 4)	267,484	191,739
Deferred credits and other long-term obligations (Note 5)	28,648	29,491
Deferred income taxes	37,424	18,643
	412,955	301,238
Shareholders' Equity		
Share capital (Note 6)	435,951	441,517
Contributed surplus (Note 6)	72,305	73,679
Deficit	(114,236)	(126,838)
	394,020	388,358
	<u>\$ 806,975</u>	<u>\$ 689,596</u>

On behalf of the Board:



Director



Director

Consolidated Statements of Income and Deficit

Years Ended December 31 (\$ thousands, except per share amounts)	1997	1996
Revenues		
Crude oil and natural gas sales (Note 7)	\$ 257,137	\$ 239,997
Royalties	(44,329)	(47,612)
Other	1,778	1,948
	214,586	194,333
Expenses		
Operating	62,980	45,569
General and administrative	7,059	9,443
Interest on long-term debt	15,637	12,559
Depletion, depreciation and future site restoration (Note 3)	94,817	79,371
	180,493	146,942
Income before taxes	34,093	47,391
Income and other taxes (Note 8)		
Current	2,710	3,029
Deferred	18,781	27,429
	21,491	30,458
Net income for the year	12,602	16,933
Deficit, beginning of year	(126,838)	(143,771)
Deficit, end of year	\$ (114,236)	\$ (126,838)
Net income per common share (basic and fully diluted) (Note 6)	\$ 0.13	\$ 0.18

Consolidated Statements of Cash Flow

Years Ended December 31 (\$ thousands)	1997	1996
Operating Activities		
Net income for the year	\$ 12,602	\$ 16,933
Add (deduct) non-cash items:		
Depletion, depreciation and future site restoration	94,817	79,371
Deferred income taxes	18,781	27,429
Amortization of deferred credits and other long-term obligations	1,996	(1,675)
Funds from operations	128,196	122,058
Change in working capital other than cash	11,652	10,316
Cash provided by operating activities	139,848	132,374
Investing Activities		
Expenditures on property, plant and equipment	(173,371)	(106,327)
Acquisitions (Note 2)	(141,071)	(86,388)
Proceeds on sale of property	60,099	24,373
Change in working capital other than cash	6,001	7,977
Cash used in investing activities	(248,342)	(160,365)
Financing Activities		
Increase (decrease) in long-term debt	71,409	(26)
Purchase of common shares (Note 6)	(7,279)	(656)
Common shares issued (Note 6)	339	22,133
Cash provided by financing activities	64,469	21,451
Decrease in cash during the year	(44,025)	(6,540)
Cash, beginning of year	47,088	53,628
Cash, end of year	\$ 3,063	\$ 47,088

Cash consists of cash and temporary cash investments.

notes to the consolidated financial statements

All tabular amounts expressed in
thousands of dollars.

(1) Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

Form 40-F, filed with the United States Securities and Exchange Commission, includes a summary of the differences between generally accepted accounting principles in Canada and those accepted in the United States.

(i) Principles of Consolidation

The consolidated financial statements include the accounts of Numac Energy Inc. ("Numac") and all of its subsidiaries. The primary entities owned 100% by Numac are Canadian Roxy Petroleum Ltd. and Numac Energy, an Alberta general partnership.

(ii) Property, Plant and Equipment

a) **Capitalized Costs** The Company follows the full cost method of accounting whereby all costs associated with the exploration for and development of crude oil and natural gas reserves are capitalized in cost centres on a country by country basis and charged against income as set out below. Such costs include land acquisition, drilling, geological and geophysical, facilities, and related overhead.

Proceeds on disposition of oil and gas properties and production equipment are credited against accumulated costs. However, when such a disposal would change the rate of depletion and depreciation by more than 20%, a gain or loss is recorded.

b) **Depletion and Depreciation** Capitalized costs of properties having proved reserves, including a provision for future costs to develop such reserves, are amortized through depletion and depreciation charges using the unit of production method based on estimated proved crude oil and natural gas reserves, as determined by independent reservoir engineers. For purposes of these calculations, production of crude oil, natural gas liquids, natural gas, and proved reserves before royalties, are converted to a common unit of measure on the basis of their approximate relative energy content. Costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment occurs. Other fixed assets are depreciated on a straight-line basis at rates of 10 to 20% per annum.

c) **Ceiling Test** The net carrying value of the Company's oil and gas properties and production equipment in cost centres is limited to an estimated recoverable amount. This amount is calculated as the aggregate future net revenues from proved reserves plus the cost of unproved properties, net of impairment allowances, less future expenditures required to develop and produce the reserves. Future net revenues are calculated using prices in effect at the Company's year end without escalation or discounting.

The net carrying value of all cost centres, less related accumulated provisions for future site restoration costs and deferred income taxes, is further limited to the total estimated recoverable amount of all cost centres less future general and administrative costs, financing costs and income taxes.

d) **Site Restoration** Future estimated site restoration costs for property, plant and equipment, net of expected recoveries, are accrued and charged against income over the life of the estimated proved crude oil and natural gas reserves using the unit of production method. Site restoration expenditures incurred are charged to the accumulated provision for future site restoration.

(iii) Joint Interest Operations

Substantially all of the Company's exploration and development activities are conducted jointly with other parties and, accordingly, the accounts reflect only the Company's proportionate interest in such activities.

(iv) Hedging

The Company enters into various swap agreements to reduce its exposure to interest rate, foreign exchange, and crude oil and natural gas commodity price fluctuations related to future sales. Gains or losses on these contracts, which constitute effective hedges, are deferred and recognized as a component of the related transaction.

(v) Foreign Exchange Gains and Losses

Monetary assets and liabilities of the Company which are denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date, while non-monetary assets and liabilities are translated at rates of exchange prevailing on the transaction dates. Revenue and expense items are translated at the average rates of exchange during the period. Gains and losses on translation are included in net income for the year, except for unrealized foreign exchange gains and losses on long-term monetary assets and liabilities, which are deferred and amortized, on a straight-line basis, over the remaining lives of the related assets or liabilities.

(2) Acquisition of Smart On Resources Inc. ("SOR")

On November 1, 1996, Numac acquired all of the outstanding shares of SOR, a private oil and gas company which was previously 100% owned by two shareholders having a combined 35% ownership interest in Numac. The purchase of SOR, for total consideration of \$48,947,000 was approved by the Board of Directors on the recommendation of an Independent Committee of the Board. Cash consideration was \$26,814,000. The remainder of the purchase price was made through the issuance of 3,670,476 Numac common shares with an ascribed value of \$22,133,000. The acquisition has been accounted for using the purchase method, whereby the purchase price was attributed to the assets and liabilities acquired, based on an estimate of their fair values as follows:

Property and equipment	\$	51,251
Working capital		(2,304)
Purchase price	\$	48,947

(3) Property, Plant and Equipment

	1997	1996
Cost	\$ 2,038,453	\$ 1,809,510
Accumulated depletion and depreciation	1,301,965	1,211,645
Net book value	\$ 736,488	\$ 597,865

Included in oil and gas properties at December 31, 1997 are costs of \$119,086,000 (1996 – \$94,686,000) related to unproved properties that have been excluded from costs subject to depletion.

(4) Long-term Debt

	1997	1996
Unsecured credit facility:		
LIBOR loan (US\$117,000,000)	\$ 167,205	\$ 160,020
Bankers' acceptances	71,651	–
Non-recourse loan	1,628	1,719
7% debentures	30,000	30,000
Less: current portion of 7% debentures	(3,000)	–
	\$ 267,484	\$ 191,739

The Company's unsecured credit facilities with two Canadian chartered banks provide for a \$310,000,000 revolving loan and a \$30,000,000 operating loan. The revolving loan may be extended annually at the option of the banks or converted to a term loan. Under a term loan, the outstanding loan would be repaid in equal payments over a period of five years. The revolving loan provides for various interest rate options, all of which are based on market rates in effect from time to time. The average effective rate of interest on borrowings under the credit facility was approximately 5.9% in 1997 (1996 – 6.4%).

The operating loan facility is reviewable annually and may be renewed for up to one year on terms and conditions agreed to by the Company and its bankers.

The unsecured 7% subordinated debentures are redeemable at par and mature April 15, 2002. The Company is required to make minimum annual sinking fund payments of \$3,000,000 in the years 1998 through 2002.

The non-recourse loan from the Alberta Oil Sands Technology and Research Authority is to be repaid from production proceeds from certain petroleum and natural gas properties and is secured by an assignment of these properties.

(5) Deferred Credits and Other Long-term Obligations

	1997	1996
Future site restoration	\$ 28,116	\$ 23,766
Office lease obligations	6,344	7,576
Pension liability	4,184	3,742
Unrealized foreign exchange loss	(9,996)	(5,593)
	\$ 28,648	\$ 29,491

(6) Share Capital

Authorized:

The Company's authorized share capital consists of an unlimited number of common shares and first and second preferred shares.

Issued:

	1997		1996	
	Shares	Amount	Shares	Amount
Common Shares				
Balance, beginning of year	96,951,164	\$ 441,517	93,399,288	\$ 419,924
Issued pursuant to acquisition of SOR (i)	—	—	3,670,476	22,133
Purchase of shares (ii)	(1,297,681)	(5,905)	(118,600)	(540)
Issued under employee stock option plan (iii)	63,029	339	—	—
Balance, end of year	95,716,512	\$ 435,951	96,951,164	\$ 441,517

(i) On November 1, 1996, the Company issued 3,670,476 shares at \$6.03 per share as partial consideration for all the issued and outstanding shares of Smart On Resources Inc. ("SOR").

(ii) Numac had a normal course issuer bid arrangement in place from December 19, 1996 to December 18, 1997. Effective December 19, 1997 and terminating on December 18, 1998, the Company has approved a normal course issuer bid to purchase up to 5% of its issued and outstanding common shares. During 1997, the Company purchased 1,297,681 shares (1996 – 118,600 shares). The excess of purchase price over book value has been charged to contributed surplus.

(iii) At December 31, 1997, there were 7,048,602 shares (1996 – 5,421,125 shares) reserved for issuance upon exercise of stock options outstanding to employees and former employees of Numac at exercise prices ranging from \$5.375 to \$8.875. The options expire as follows: 477,533 in 1998; 1,617,600 in 1999; 1,262,869 in 2000; 1,112,400 in 2001; and 2,578,200 in 2002.

Weighted Average:

Net income per common share has been calculated based on weighted average number of common shares of 96,396,808 for the year ended December 31, 1997 (1996 – 94,008,145).

(7) Financial Instruments

The Company's financial instruments within the consolidated balance sheets consist of substantially all current assets and liabilities as well as long-term debt. The fair market values of these financial instruments approximate their carrying values.

Credit Risk

The Company is exposed to credit risk from financial instruments to the extent of non-performance by third parties. A substantial portion of the Company's accounts receivable are with customers and joint venture partners in the petroleum and natural gas industry and are subject to normal credit risks. The Company is also exposed to credit risk associated with possible non-performance by counterparties to swap agreements. The Company minimizes credit risk associated with swap agreements by entering into contracts with only highly rated financial institutions, and controls other third party credit risk with credit approvals, limits on exposures to any one counterparty, and monitoring procedures.

Financial Derivative Swaps

The Company enters into various swap agreements to mitigate risks associated with commodity prices, currency exchange rates related to future crude oil and natural gas sales, and interest rates. A swap is a financial derivative instrument whereby the Company and a third party agree to exchange, at specified intervals, the difference between an agreed fixed commodity price, interest rate or exchange rate and floating prices or rates calculated by reference to an agreed notional volume or principal amount. There is no obligation to deliver or receive quantities of crude oil or natural gas pursuant to a swap contract.

(i) Natural Gas

The Company has entered into natural gas swap contracts to fix natural gas prices and gas basis differentials on approximately 12 million cubic feet per day for the period January to December 1998, and 10 million cubic feet per day for the period January to October 1999.

(ii) West Texas Intermediate Crude Oil

The Company has entered into West Texas Intermediate crude oil swap contracts to fix crude oil prices on 2,000 barrels per day for the period January to December 1998 at an average price of US\$20.75 per barrel.

(iii) Foreign Exchange

The Company has entered into swap contracts on US\$/CDN\$ exchange rates in order to reduce exposure to fluctuating foreign exchange rates. The Company has hedged US\$5.5 million per month for the period January to December 1998 at an average exchange rate of US\$0.7213/CDN\$1.00.

Fair Market Value of Financial Derivative Swaps

The fair market value of the financial derivative swaps represents the amount that the swap agreements could have been settled for, given market conditions at December 31, 1997 and 1996.

	1997	1996
Natural gas	\$ 1,579	\$ (165)
West Texas Intermediate crude oil	2,494	(6,733)
Foreign exchange	(2,394)	1,288
Interest rate	-	(45)
	<u>\$ 1,679</u>	<u>\$ (5,655)</u>

(8) Income and Other Taxes

The provision for income taxes varies from the amounts that would be computed by applying the combined Canadian federal and provincial income tax rates for the following reasons:

	1997	1996
Canadian federal and provincial income tax rates	44.9%	44.8%
Federal and provincial income tax rates applied to		
income before taxes	\$ 15,308	\$ 21,231
Add (deduct) income taxes resulting from:		
Non-deductible Crown payments (net of Alberta Royalty		
Tax Credit) greater than federal resource allowance	454	1,806
Depletion and depreciation on assets with tax basis		
less than cost	2,114	4,416
Large corporations tax and provincial capital taxes	3,168	3,029
Other	447	(24)
Provision for income and other taxes	<u>\$ 21,491</u>	<u>\$ 30,458</u>

The Company has the following tax pool deductions available to reduce future taxable income:

	1997	1996
Canadian oil and gas property expense	\$ 191,810	\$ 96,784
Undepreciated capital cost	153,620	111,877
Canadian development expense	89,948	57,702
Canadian exploration expense	80,702	87,470
Foreign exploration and development expense	23,469	23,433
Earned depletion base and other	17,215	15,294
Attributed Canadian royalty income deduction	43,741	28,364
	<u>\$ 600,505</u>	<u>\$ 420,924</u>

(9) Pension Plan

The present value of the actuarial pension obligation and the market value of the pension fund assets for the Company's defined benefit pension plan are as follows:

	1997	1996
Accrued pension obligation	\$ 11,809	\$ 12,111
Pension fund assets	\$ 16,849	\$ 16,573

(10) Commitments

The Company leases various types of property and equipment through operating leases. Minimum payments under non-cancellable operating leases with terms of one year or more are as follows:

1998	\$ 5,251
1999	5,480
2000	5,480
2001	5,080
2002	4,197
After 2002	837
Total	\$ 26,325

(11) Comparative Figures

Certain comparative figures have been reclassified to conform with the 1997 presentation.

five year review

(\$ thousands)	1997	1996	1995	1994	1993
Financial					
Revenues					
Crude oil and natural gas liquids, less royalties	\$ 132,600	\$ 126,153	\$ 118,725	\$ 124,690	\$ 88,769
Natural gas, less royalties	80,208	66,232	72,364	80,943	51,810
Investment and other income	1,778	1,948	2,525	23,316	12,363
	214,586	194,333	193,614	228,949	152,942
Expenses					
Operating, general and administrative	70,039	55,012	59,807	58,048	50,728
Interest on long-term debt	15,637	12,559	13,106	11,220	8,354
Depletion, depreciation and future site restoration	94,817	79,371	104,699	98,531	63,899
Write down of property, plant and equipment	—	—	242,151	—	—
Loss on termination of lease	—	—	—	—	7,315
	180,493	146,942	419,763	167,799	130,296
Income (loss) before taxes and non-controlling interest	34,093	47,391	(226,149)	61,150	22,646
Provision for (recovery of) income taxes					
Current	2,710	3,029	2,855	2,785	(4,011)
Deferred	18,781	27,429	(50,204)	31,868	15,363
	21,491	30,458	(47,349)	34,653	11,352
Non-controlling interest	—	—	—	37	(209)
Net income (loss) for the year	\$ 12,602	\$ 16,933	\$ (178,800)	\$ 26,460	\$ 11,503
Funds from operations	\$ 128,196	\$ 122,058	\$ 117,500	\$ 144,818	\$ 97,782
Capital expenditures	\$ 314,442	\$ 141,464	\$ 116,772	\$ 168,093	\$ 118,483
Acquisition of Smart On Resources Inc.	—	51,251	—	—	—
Investment in Canadian Roxy Petroleum Ltd.	—	—	—	12,885	—
Acquisition of Numac Oil & Gas Ltd.	—	—	—	—	164,960
	\$ 314,442	\$ 192,715	\$ 116,772	\$ 180,978	\$ 283,443
Operating					
Average daily production for the year, before deduction of royalties:					
Crude oil and natural gas liquids (Bbls/day)	20,537	18,860	19,097	20,536	15,698
Natural gas (Mmcft/day)	140.8	128.7	150.8	138.7	99.8
Proved reserves, before deduction of royalties:					
Crude oil and natural gas liquids (Mbbbls)	57,729	51,459	46,535	51,216	50,957
Natural gas (Bcf)	455.0	389.0	390.9	490.3	494.8

supplementary information

Selected Financial Ratios

	1997	1996
Cash flow per common share (basic)	\$ 1.33	\$ 1.30
Net income per common share (basic)	\$ 0.13	\$ 0.18
Debt, net of working capital/cash flow	2.2	1.3
Debt, net of working capital/debt plus equity	0.4	0.3
Operating costs per BOE	\$ 4.98	\$ 3.92
General and administrative expense per BOE	\$ 0.56	\$ 0.81
Netbacks per BOE	\$ 11.86	\$ 12.65
Cash flow per BOE	\$ 10.15	\$ 10.51

Quarterly Financial Information

(\$ thousands)	First	Second	Quarters Third	Fourth	Full Year
1997					
Gross production revenue	69,383	56,042	60,394	71,318	257,137
Funds from operations	38,029	27,547	29,154	33,466	128,196
Net income	8,151	2,423	182	1,846	12,602
1996					
Gross production revenue	55,531	57,600	58,624	68,242	239,997
Funds from operations	27,349	28,808	29,667	36,234	122,058
Net income	3,283	3,480	3,472	6,698	16,933

Stock Exchange Listings and Trading of Numac Shares

Numac shares are listed for trading on The Toronto Stock Exchange ("TSE"), The Montreal Exchange ("ME") and the American Stock Exchange ("AMEX"). The following table sets forth the price range and trading volume of Numac's Common Shares for each quarter of 1997, as reported by the TSE and AMEX:

	TSE (CDN Dollars)			AMEX (U.S. Dollars)		
	High	Low	Volume	High	Low	Volume
1997						
First quarter	\$ 6.45	\$ 5.20	5,474,326	\$ 4.75	\$ 4.43	149,000
Second quarter	6.00	5.35	1,977,896	4.44	4.25	215,300
Third quarter	7.20	5.80	1,824,200	5.25	3.93	291,000
Fourth quarter	7.00	5.25	3,422,829	4.93	3.87	803,200
Full year	7.20	5.20	12,699,251	5.25	3.87	1,458,500

Abbreviations in this Annual Report

Bbl	– barrel	Mcf	– thousand cubic feet
Bbls/day	– barrels per day	Mmcf	– million cubic feet
Mbbls	– thousand barrels	Mmcf/day	– million cubic feet per day
BOE	– barrels of oil equivalent, which is computed on the basis of 10 Mcf of natural gas equalling 1 Bbl of oil.	Bcf	– billion cubic feet
		MBOE	– thousand BOE
		MMBOE	– million BOE

Directors

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Chairman and
Chief Executive Officer
Numac Energy Inc.
Calgary, Alberta

Douglas W.T. Chan^{1,3}
Managing Director
New World
Infrastructure Limited
Hong Kong

Gaim K.Y. Lam
Vice-Chairman
Henderson Land
Development Co. Ltd.
Hong Kong

Daniel K.K. Lau^{2,3}
Vice-President and Director
HSBC James Capel Canada Inc.
Toronto, Ontario

William S. McGregor
Honorary Chairman
Numac Energy Inc.
Edmonton, Alberta

W. Roger McKeough^{1,2}
Chairman
McKeough Sons
Company Limited
Chatham, Ontario

Michael C.W. Pui^{1,2}
Assistant to
Managing Director
New World
Development Co. Ltd.
Hong Kong

Theodore D. Rennie^{1,2}
Chairman and
Chief Executive Officer
Vista Energy Inc.
Regina, Saskatchewan

S.F. Shumwiler Sr.
Director
Shun Tak Holdings Ltd.
Hong Kong

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Dean, Richard Ivey
School of Business
London, Ontario

Donald J. Taylor^{1,3}
Chairman
IPL Energy Inc.
Jackson's Point, Ontario

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Chief Executive Officer

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Senior Vice-President,
Exploration and Production

John E. Flynn
Vice-President, Operations

Dale J. Hohm
Vice-President, Finance and
Corporate Secretary

Michel E. Scott
Vice-President, Marketing and
Business Development

Lorraine K. McVean
Assistant Corporate Secretary

John W. Nearing
Controller

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Price Waterhouse
Calgary, Alberta

Legal Counsel

Burnet, Duckworth & Palmer
Calgary, Alberta

Osler, Hoskin & Harcourt
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Shareholder Inquiries

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Information Form filed with
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and the Form 40-F filed with the
Securities and Exchange
Commission in the United States
may be obtained by contacting
Dale J. Hohm, Vice-President,
Finance and Corporate Secretary
of the Company.

¹ member of the Executive Committee
² member of the Compensation Committee
³ member of the Audit Committee



Numac Energy Inc.

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